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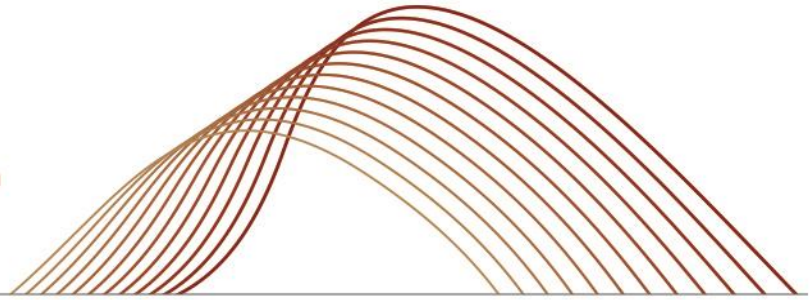

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The Return of Stock as Currency in Acquisition Transactions

By David Shine, Darcy White & Russell Franklin

In the public M&A market, all-cash deals have been king for the past few years even while stock prices (and thereby the value of stock as potential deal currency) have been at or near all-time highs. Recently, however, there has been a spate of transactions in which stock is used as deal currency. Part cash/part stock consideration is used in Cigna's acquisition of Express Scripts, Lumentum's acquisition of Oclaro, and in Salesforce.com's acquisition of Mulesoft.

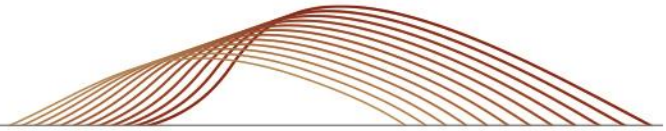
Because the use of stock as deal currency may be increasing, it is opportune to review the principal issues regarding the structure of the purchase price in these transactions: pricing formulas, allocation of consideration, and oversubscriptions in cash election transactions.

Pricing Formulas. The first issue to consider in a part cash/part stock transaction is whether the stock portion of the consideration will be at a fixed ratio or at a fluctuating ratio.

Cash, and Stock at Fixed Ratio. This formula provides cash at a fixed amount and stock at a fixed exchange ratio. The ratio used would be intended to reflect a value based on the acquirer's pre-announcement stock price. All three of the recent transactions noted above used a fixed exchange ratio (e.g., in the Cigna transaction each Express Script share is entitled to $48.75 in cash and 0.2434 shares of Cigna common stock).

As the value of the acquirer stock fluctuates between signing and closing, the value of the stock component will also fluctuate (while the value of the cash component remains fixed). As a result, targets may seek a collar to preserve relative balance of the cash and stock portions of the consideration, a right to terminate the merger agreement if the acquirer stock falls below a specified value or a cash top-up of the stock portion if the value of acquirer stock falls below a specified value. All of these mitigating provisions are, however, fairly uncommon in recent practice.

Cash, and Stock at Fluctuating Ratio. This formula provides cash at a fixed amount and stock at a fluctuating exchange ratio (i.e., the ratio would be determined just prior to closing and would equal what is necessary to provide $x in value). Fluctuating ratio transactions often include a collar to set a minimum and/or a maximum aggregate number of shares that the acquirer would have to issue. Because collars increase the risk of price uncertainty, and because acquirers are not typically comfortable to committing to a fluctuating ratio without at least a maximum share collar, transactions with a fluctuating exchange ratio are much less common.



Allocation of Consideration. The second issue to consider is how the cash and stock consideration will be allocated among target shareholders. This is primarily a concern for the target, and acquirers will usually be indifferent as long as an allocation method is equitable and does not create any tax issues.

Proportional Allocation. This method provides that each target shareholder receives a mix of stock and cash for each of its shares based on the aggregate consideration mix. All three of the recent transactions noted above use this allocation method.

Cash Election. A more exotic method is to allow shareholders to elect to receive either all cash or all stock (or sometimes an elected combination of stock and cash). A target may desire this method if a merger is intended to be tax-free to its shareholders as this method may allow low basis shareholders to elect to exchange all their shares on a tax-free basis. An acquirer may want to offer this method to increase the attractiveness of its offer.

Oversubscriptions in Cash Election Transactions. The third issue is that in a cash election transaction, there may be excess subscriptions for one form of consideration. This is because the acquirer will have agreed to pay only a specified aggregate amount of cash and issue a maximum aggregate number of shares. Therefore, all target shareholders cannot receive all cash or all stock.

One manner of handling this issue is to provide that shareholders who elect to receive the oversubscribed consideration could be selected by lottery until the oversubscribed pool is sufficiently reduced. Alternatively, the acquirer could first satisfy in full the shareholders selecting the undersubscribed consideration, and then give those in the oversubscribed pool a proportionate share of cash and stock (i.e., they would not get 100% of what they elected).

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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